

# Property Owning Trusts

Many property investors purchase their properties through trust structures in order to secure asset protection, grow long term wealth for the family and as a result minimise their tax exposure. What is often not appreciated by many of those that create these trust structures are the unique subtleties that define these entities. Simply creating a trust and then going off and investing into the property market with no thought given to the trust again (with the exception of annual gifting) will almost certainly lead to problems in the future. In order for a trust to be valid it requires certain objects, these are Settlor, Corpus, Beneficiaries and Trustees. Listed below is a review of some of the issues on these points.

## Settlor

Arguably the most important element of the trust, the person that gives the assets that form the body or corpus of the trust. It is important to remember that the sole purpose of the Settlor is to gift assets to the trust, in doing so the Settlor ceases to have legal title or control of these assets. This is very important for the long term asset protection of the trust assets. Were the Settlor to retain control of those assets that were settled into the trust, then it would be a simple matter for anyone wishing to have the settlement set aside, to do so. They could (successfully) argue that the Settlor never settled those assets into the trust and that the proof of this was their retention of control. This could have a significant impact on parties trying to differentiate between trusts that traded in properties and trust/companies that held rental properties. If the Settlor retain control of these assets then the IRD could potentially argue that the properties were never held in trust but rather they were the personal property of the Settlor, thus resulting in rental properties being tainted by the trading properties.

## Corpus

One of the most important elements of a trust is the "corpus", the body of the trust, this is formed of assets such as cash and property, held in trust for the use of the beneficiaries. It is important that when the trust is formed that some form of asset is placed into trust on the day that the Trust Deed is executed, this can take the form of NZ\$100. One of the biggest failures of trustees, especially personal trustees is the formation of a bank account in the name of the trust and the deposit of these initial settled funds. It is important that trust funds are kept separate from personal funds; this is best achieved by the opening of a bank account at the settlement of the trust. The Settlor, Beneficiaries and Trustees should not treat a trust as if it were simply another bank account into which they can dip to take funds, the matter is far more complicated than that. Assets held in trust are for the benefit of all the beneficiaries of the trust and due consideration should be given before any distribution or payment is made from trust funds.

## **Beneficiaries**

Beneficiaries are typically those parties for whom the Settlor has natural love and affection for. Typically the beneficiaries will be the Settlor's immediate family and remoter issue, and may also include the Settlor and their spouse. The beneficiaries have the right to the enjoyment of the trust assets, together with the right to receive income or capital in the form of distributions arising from those assets. Effectively beneficiaries could live in a property owned by the Trust, or receive income arising from rents received from properties held in the trust, or receive the proceeds arising from the sale of properties owned by the Trust. It should be noted that whilst they have a beneficial interest in those assets they do not have legal ownership of those assets, that ownership lies with the Trustees.

## **Trustees**

The Trustees are the legal owners of all of the trust assets, but importantly these assets are held by them for the benefit of others (the beneficiaries). The role of the Trustees is that of a custodian, looking to preserve and enhance those assets for future benefit. Trustees have a great deal of responsibility and as a result have a great many liabilities arising from such a position, it is strongly recommended that one should think long and hard before accepting a role as trustee. Where property is bought or held on behalf of a trust, then the trustees own that property, with all of the responsibilities associated with that ownership. Under the revised health and safety legislation, property that is rented or leased for a commercial gain gives rise to a responsibility for the owner of that property for any activity which takes place on that property, irrespective of whether the owner has authorised such activity or is involved in that activity.

## **Corporate trustees**

One of the principle advantages of corporate trustees is that the name on the land registry is that of a company and not individual persons. When an individual trustee retires the property needs to be conveyed into the names of the new trustees, this transfer of title can cost anywhere from \$500 - \$1,000. This fee is per property, thus where a trust has a number of properties this replacement of trustee can be expensive. Consider this, in the lifetime of a trust, 90 years; it will almost certainly be necessary to replace a trustee at least once. With a corporate trustee all that is required is that a director is replaced and the necessary filings made at the registrar of companies. In addition a company has a perpetual existence, provided the necessary annual filings are made and as a result would not need to be replaced as a trustee during the life of the trust.

## **Record keeping**

Each and every time the trustees make a decision concerning the assets of the trust or its beneficiaries then such a decision should be recorded in the form of a Minute or Resolution. This written record should detail what decisions was proposed, why it was being considered, if possible how it benefits or maintains the trust.

Where trustees are considering purchasing a property, it is important to record, where it is, how much it will cost, whether it generates any revenue and what arrangements are required to finance its purchase, such as a mortgage. It is also important to record whether the property is being purchased as a rental property or as a trade, to be sold on

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at a profit at a later date. Be sure to keep with the minute copies of all relevant correspondence with other third parties such as mortgage brokers, the bank and your accountant, which might support this minute. This can be very important if at a later date the IRD challenge a sale of a rental property and try to argue it was a trade.

### **Seek advice**

If you are a trustee of a property owning trust and are not sure if what you are doing is right or the likely tax consequences then seek advice. A few hundred dollars of professional advice could save you tens of thousands of dollars in the long term. Think of it this way an accountant might charge you \$250 for an hours consultation, the tax on a \$50,000 dollar profit is likely to be in the order of \$18,000, which would you rather pay?

Hopefully this article has made the reader aware of the myriad of pitfalls that lie in wait for the ill prepared trustee. A trust is a very powerful and useful tool for wealth management, estate planning and asset protection, however, it must be treated properly and given the care and attention that it deserves if it is to function properly. Before using a trust educate yourself as to its strengths and weaknesses, seek proper advice and be prepared to pay for it, as illustrated above advice costs a few hundred dollars, errors costs thousands.

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